



**CHOICE and
Consumer Action Law Centre
Submission to the
Senate Economics Committee Inquiry**

**Australian Securities and Investment
Commission (Fair Bank & Credit Card Fees)
Amendment Bill 2007**

31 August 2007

CHOICE is a not-for-profit, non-government, non-party-political organisation established in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the information to make confident choices and campaign for change when markets or regulation fails consumers.

CHOICE does not receive ongoing funding or advertising revenue from any commercial, government or other organisation. With over 200,000 subscribers to our information products, we are the largest consumer organisation in Australia. We campaign without fear or favour on key consumer issues based on research into consumers' experiences and opinions and the benefit or detriment they face.

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Consumer Action Law Centre (**Consumer Action**) is an independent campaign-focused consumer casework and policy organisation, dedicated to advancing the interests of low-income and vulnerable consumers, and of consumers in general. Based in Melbourne, it was formed in 2006 by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service and is funded jointly by Victoria Legal Aid and Consumer Affairs Victoria.

Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

To find out more about Consumer Action, visit www.consumeraction.org.au

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1. What are penalty fees?

A penalty fee is charged to a bank customer when the customer breaches a requirement of the terms and conditions of their bank account. For the purposes of this submission we consider penalty fees which apply to credit card accounts and transaction accounts, including cheque accounts.

CHOICE and Consumer Action believe that most penalty fees currently applied to credit card and transaction accounts are unfair and that many are unlawful. A fee can be argued to be an unlawful penalty where it satisfies the following criteria:

- it is applied in respect of a breach of contract;
- it is out of all proportion to the cost to the “innocent” party accruing from the breach; and
- the relationship between the contracting parties and whether there was any opportunity to negotiate the term, is such that it would be unconscionable for the “innocent” party to enforce the term.

This is discussed further below. Applying the above criteria, CHOICE and Consumer Action have included the following types of fees in their campaign to stamp out bank penalty fees: inward cheque dishonour fees, overlimit, late payment and payment failure fees on credit card accounts and honour or dishonour fees on transaction accounts.¹ References to penalty fees throughout this submission refer to these fees.

2. Trends in penalty fees

There are two significant trends in banking penalty fees: in general, banks are charging higher amounts and charging more often. CHOICE and Consumer Action have analysed the level of fees charged by major banks and credit unions from their fee schedules and product disclosure statements. However, information relating to the volume of fees charged, and subsequent revenue earned, is more difficult to ascertain.

Level of individual penalty fees

At Appendix 1, we outline the current penalty fee charges for standard transaction account and credit card accounts of the five major Australian banks. These fees can be as high as \$50 each and have been steadily increasing since 2002. In the case of credit card overlimit fees, the rate of growth has been exponential. These fees did not exist in 2000 and now average \$30 each (and can be as high as \$35).²

The exception to the trend has been some downward movement on concession account penalty fees. In September 2006, National Australia Bank (**NAB**) cut penalty fees altogether for

¹ Clearly the doctrine may have application in relation to other types of fees. The CHOICE and Consumer Action's campaign has focussed to date on bank penalty fees.

² Reserve Bank of Australia, *Banking fees in Australia*, Reserve Bank Bulletin, May 2007

concession card holders. ANZ recently reduced fees from \$35 to \$10 for concession card holders. These are moves that have been public welcomed by our organisations. The Australian Bankers Association (**ABA**) has summarised these movements in its Industry Fact Sheet.

Reduced rates for the most disadvantaged members of our community are a very welcome initiative. However, not all institutions have taken this step, and the fact remains that penalty fees for the majority of consumers have increased.

To give some examples, since 2005 Westpac's transaction account penalties have increased by 25-33% and its credit card penalties increased by 16-40%. St George Credit Card penalties increased by 40-50% during these two years. ANZ reduced its dishonour fee from \$45 to \$35 but increased its overdrawn account fee from \$29.50 to \$35.

Volume of fees levied

Banks are charging higher amounts in penalty fees, as well as charging them more often. In its recent Bulletin on banking fees, the Reserve Bank of Australia (**RBA**) showed that total fee income earned from household deposit and credit card accounts was over \$4 billion in 2006.³ That represented a ten per cent increase on 2005 fee income. Between 2002 and 2006 fee income increased by 45% on deposit accounts and a massive 140% on credit card accounts. The RBA, however, does not collect data on income derived specifically from penalty fees. It does separately account for 'other' credit card fee income. Other fees – which are mainly penalty fees and foreign currency conversion fees – delivered \$90 million revenue in 2006.

The data on penalty fee income is inadequate. Consumers would benefit from more detailed collection of data on penalty fees charged by financial institutions. However, it is apparent that fee income has increased and done so at a greater rate than the growth in the amount of individual fees.

3. Consumer experiences of penalty fees

CHOICE and Consumer Action established a website, www.fairfees.com.au, to assist consumers to reclaim unfair penalty fees and speak out in support of government action. Since the website launched on 19 June 2007, over 15,000 standard letters to reclaim fees have been downloaded and hundreds of consumers have written to us sharing their stories of unfair penalty fees. At 31 August 2007, 1150 people from all states and territories, have signed on to a letter (at Appendix 2) urging the Government and Opposition to take action on penalty fees.

From the hundreds of stories emailed to us, it is clear that consumers object to penalty fees on a range of grounds. These objections are reflected below in a small selection of stories.⁴ Their

³ RBA, *Banking fees in Australia*, Reserve Bank Bulletin, May 2007

⁴ These stories were sent directly to CHOICE via the campaign website and are presented anonymously with respect to both customers and their banks.

experiences help identify the failures present in the banking and credit sectors and support the case for urgent regulatory action.

Penalty fees are high in amount relative to the costs incurred by the bank:

"I did not begrudge the bank their right to charge fees for overdrawn accounts - I did however explain that the amount is excessive. [The bank] was unable to tell me the true cost of overdrawn accounts"

"I was rung by the bank and they stated that it is their right under the terms and conditions to charge whatever fee they like for the service they provide... Attempts to raise the matter of the fee being excessive drew the response that the bank is a business and (again) it's their right under the terms and conditions to charge these fees, regardless of the actual costs incurred providing it."

The bank could easily assist the consumer to avoid the fee but chooses not to:

"After once over-drawing my cheque account... I got [the bank] to disallow over-drawing on that account. Twice since then, I inadvertently and unknowingly overdrew my account, only to find that I got charged \$30 each time. When I approached [the bank] with these charges, the banker with whom I spoke acknowledged that I had indeed successfully requested for my account to be disallowed from being overdrawn, but that "sometimes if you pay by EFTPOS, and there are not enough funds in your account to cover the charge, [the bank] still has to honour the transaction. That's just the process. You should just be more careful next time."

Penalty fees can disadvantage people already experiencing financial distress:

"During the period of Jan 01 to Oct 05 I was charged over \$2,900 dollars in late, overdrawn and dishonour fees. During this time I was trying to find stable employment and was experiencing severe financial hardships. My case is a pretty rare one I think but it's very severe and I felt almost persecuted by the bank being pushed to the point of... Well I don't really need to go into it."

Penalty fees are implemented unilaterally and automatically

"My credit card was allowed to run over credit to by the amount of \$1200.00 in excess of the agreed credit limit. Rather than stop the card they have hit me with penalties totalling \$4000.00, and I find it impossible to pay the money back even though I pay the minimum each month and the card has not been used since August 2006."

"If I go even a dollar over I get charged \$35 PER DAY, it gets harder and harder to pay it off when this happens, if its just after pay day, that can add up to \$245 for a week?"

Penalty fees frequently apply to trivial defaults or unintentional errors by consumers:

“In March last year, I was due to pay my monthly fee of \$5, plus another \$1.50 for Internet and visa debit card fees. This took my account to \$0.84 overdrawn, for which I was charged a \$30 overdrawn fee, and \$0.60 in interest.”

Penalty fees are often high in amount relative to the penalised transaction

“On receiving a bill for around \$30, I ensured I had exactly \$30 in the bank to cover the cheque and sent payment off. To my horror, the bank decided to take some 2cent charge out of the account which bounced the cheque. The bank charged me \$50 for the default and the company I was paying charged me \$20 for the bounced cheque they had banked. So \$70 later, the \$30 bill I had intended to pay was still unpaid.”

4. Market failure in penalty fees⁵

The ABA recently claimed that greater disclosure will drive the industry towards better penalty fee offerings.⁶ We do not believe this claim can be sustained.

There is little competitive pressure on financial institutions to keep fees in check. Consumers do not expect to pay penalty fees at the time they open an account or take out a loan or credit card and thus do not shop around for new a bank on the basis of the penalty fees they charge (or more importantly, don't charge). Indeed, there is not enough competition even on core issues such as price and service among banking products generally, with consumers demonstrating significant inertia. Consumers do not generally have the market power to negotiate the terms and conditions of clauses in contracts. We believe this creates an inbuilt temptation to add in unjustifiable margins when setting these fees.

While better disclosure of fees is welcome, focusing on it as a solution to the penalty fees problem misses the point. There is little competitive pressure on financial institutions to keep fees in check. Disclosing fees in a product disclosure statement will never address the critical underlying problem: that penalty fees have inflated to unacceptably high levels.

In Australia financial institutions are very reluctant to discuss what the underlying administration costs are. The ABA says its members consider this information to be commercially sensitive and won't disclose it.⁷

If competitive processes were able to exert maximum impact on penalty fees we would expect these fees to be set at the level of administration costs. Where there is a breakdown in competition we would expect them to increase faster than inflation, and to vary across the sector, as some consumers tolerate higher levels of fees than others. That certainly looks like

⁵ This section draws from *Time to get honest on unfair fees* Paper written for the BFSAs Annual Conference 2006 session on late payment and early termination fees. Dr. Nick Coates, Senior Policy Officer, Australian Consumers' Association

⁶ ABA Industry Fact Sheet, available at: www.bankers.asn.au/factsheet/exceptionfee.

⁷ Dooley, A. (2005), "How to beat bank penalty fees", *Choice Money and Rights*, August/September, pp13-18.

the pattern in Australia, but as outlined previously, there is insufficient public data to make an accurate and conclusive assessment of genuine administrative costs.

5. Penalty fees: the legal argument⁸

What is a 'penalty' at law?

Any contract may include a term that, if a party breaches the contract or defaults in some way, that party must pay the other "innocent" party a sum of money. The legal principles regarding such clauses or terms are relatively well-established.⁹

Whether a contractual term for the payment of money is an unlawful penalty or simply a reasonable pre-estimate of loss (liquidated damages) is a question of degree which turns on all the circumstances of the case. In particular, a term is likely to be a penalty if:

1. The sum to be paid under the term by the party in breach is out of all proportion or extravagant, exorbitant or unconscionable in comparison with the loss suffered by the "innocent" party; and/or
2. The relationship between the contracting parties and whether there was any opportunity to negotiate the term, is such that it would be unconscionable for the "innocent" party to enforce the term.

In addition, it is important to remember that the question is one 'not of words or of forms of speech, but of substance and of things'.¹⁰ In other words, although banks describe various payments as "fees", for example cheque or direct debit dishonour fees or late payment fees, this does not demonstrate that they are not, in fact, penalties.

If such fees are, in fact, penalties at law, they are unenforceable by the banks against their customers.

Are banks charging illegal penalty fees?

While banks are entitled to recover costs incurred by them upon default by a customer, they are not entitled to use a penalty term to do so.

There is insufficient public data available to make an accurate and conclusive assessment of whether penalty fees are liquidated damages or penalties. For this reason, there is a need for effective disclosure of costs incurred by banks in processing customer defaults. Banks should not be troubled by this if penalty fees are simply an exercise in cost recovery.

⁸ The text under this heading is largely derived from Nicole Rich's report 'Unfair fees: a report into penalty fees charged by Australian banks' (2004, Consumer Law Centre Victoria) (*the Rich Report*).

⁹ See, for example, *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359 at 368 per Gibbs CJ.

¹⁰ *Clydebank Engineering and Shipbuilding Co v Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6 at 15 per Lord Davey.

However, from the information that is currently available, it is very likely that penalty fees charged by Australian banks are penalties at law and therefore unenforceable.

1. Penalty fees are out of all proportion or extravagant, exorbitant or unconscionable in comparison with the loss suffered by the bank in processing a customer default

Using publicly available data obtained from the RBA, and from the Wallis Committee's Final Report of the Financial System Inquiry (March 1997), the Rich Report concludes that Australian banks could be charging consumers cheque dishonour fees between 5 to 16 times what it costs them to process a cheque dishonour and direct debit dishonour fees between 64 to 92 times what it costs them to process a direct debit dishonour.

Applying the first limb of the legal test as to when a term will be a penalty at law, such cheque and direct debit dishonour fees are clearly out of all proportion or extravagant, exorbitant or unconscionable in comparison with the loss suffered by the bank in processing a dishonour.

2. The relationship between the bank and the customer, including the relative bargaining position of the parties and the lack of opportunity to negotiate penalty fees, is such that it would be unconscionable for the bank to enforce penalty fees against customers

The relationship between banker and customer is characterised by unequal bargaining power and a lack of ability on the part of consumers to negotiate any terms, let alone penalty fees, with banks. Further, banks are in a position to levy the fees automatically – applying them directly to consumers' accounts.

What about unfair contract term laws?

Victoria is the only jurisdiction in Australia to enact laws prohibiting unfair contract terms. The provisions of Part 2B of the *Fair Trading Act 1999* (Vic) (**FTA**) render void any term in a consumer contract that is unfair (as defined). If a contract term which imposes a cheque or direct debit dishonour fee breaches Part 2B of the FTA, it will be void in Victoria, quite apart from whether or not it is also unenforceable as a penalty at law.¹¹

Section 32W of the FTA provides that:

'A term in a consumer contract is to be regarded as unfair if, contrary to the requirements of good faith and in all the circumstances, it causes significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer'

This has been interpreted by the President of VCAT, Justice Morris, in *Director of Consumer Affairs Victoria v AAPT Ltd*,¹² to mean that there are two types of unfair terms:

¹¹ Section 32V of the FTA excludes credit contracts from the operation of Part 2B. As such, the Part would not apply to penalty fees in credit card accounts, but would to transaction accounts. We note that the Victorian Government has committed to extending the operation of Part 2B to credit contracts.

¹² [2006] VCAT 1493 (2 August 2006).

- terms that cause such an imbalance that they are unfair even if they were individually negotiated or brought to the consumer's attention;
- other terms that cause less (but still significant) imbalance, which will only be fair if they were individually negotiated or brought to consumer's attention.

This interpretation is important – just because a bank discloses the existence of a penalty fee upfront, it may still be an unfair contract term if it is found to cause a significant imbalance in the rights and obligations arising under the contract, to the detriment of the consumer.

Justice Morris also said that the word 'significant' meant 'important' or 'of consequence', rather than 'substantial'; that the phrase 'significant imbalance' simply meant an imbalance that was unfair; and that section 32X provided detailed guidance in assessing what terms are unfair. Section 32X provides:

'Without limiting section 32W, in determining whether a term of a consumer contract is unfair, a court or the Tribunal may take into account, among other matters, whether the term was *individually negotiated*, whether the term is a prescribed unfair term and whether the terms has the object or effect of –

... (c) *penalising the consumer but not the supplier for breach or termination of the contract*

... (h) *permitting the supplier unilaterally to determine whether the contract had been breached or to interpret its meaning*' (emphasis added).

In our view, a term in a contract between a financial institution and a customer that imposes a penalty fee does cause a significant imbalance in the parties' rights and obligations to the detriment of the consumer, and thus could be found to be unfair. Such a term explicitly provides for the customer, but not the bank, to be automatically penalised upon a breach of contract, with the bank having the sole power to determine when this has occurred. As set out above, these factors are explicitly listed as relevant under section 32X.

It is important to note that action taken by the UK Office of Fair Trading (**OFT**) (described further below) in relation to penalty fees charged by banks in the UK is pursuant to laws very similar to Part 2B of the FTA. Based on European Court of Justice jurisprudence,¹³ it has underlined the need for consideration to be given to the consequences of a term under national law in assessing contractual unfairness. As such, the OFT has based its decision that penalty terms are unfair on a finding that they are penalties at law.

¹³ *Frieburger Kommunalbauten GmbH Baugesellschaft & Co KG v Hofstetter* C-237/02 [2004] 2 CMLR 13.

6. Practical limitations to consumers challenging penalty fees

Consumers, when charged a penalty fee, can challenge its imposition by complaining directly to the bank. Since the launch of our campaign and website, www.fairfees.com.au, many consumers have successfully challenged penalty fees, using the pro forma letters available for download on that site. However, when a bank or financial services provider refuses to refund a penalty fee, consumers are faced with limited alternative options – namely to seek redress through external dispute resolution or to pursue the issue through a court or tribunal. For the reasons outlined below each of these options has significant limitations.

All financial services providers in Australia (as well as a range of other persons who issue certain financial products) are required to be members of an approved external dispute resolution scheme.¹⁴ There are a range of approved schemes.¹⁵ The Banking and Financial Services Ombudsman (**BFSO**) is the scheme which covers Australian banks together with some additional financial services providers. The Credit Ombudsman Scheme Limited (**COSL**), the Credit Union Dispute Resolution Centre and the Financial Co-operatives Disputes Resolution Centre (**FCDRS**) also have relevant jurisdiction.

The BFSO has stated publicly that it does not consider it has jurisdiction to investigate complaints relating to penalty fees. It appears this view is formed on the basis that the BFSO's terms of reference exclude complaints arising from a policy or practice of a bank, unless that policy or practice is in breach of a specific obligation or duty to the customer.¹⁶ The BFSO states that the level of fees and charges is a bank policy or practice.

It is our view that whether or not a fee charged is an unlawful penalty involves questions of legal obligations or duties, as opposed to merely raising issues of banks' fee setting policy, and therefore the BFSO could and should accept complaints about penalty fees. We have made such representations to the BFSO.

COSL, however, has indicated its willingness to investigate complaints about penalty fees.¹⁷ The Financial Co-operatives Dispute Resolution Centre has foreshadowed that it is reviewing its position relating to complaints about the level of penalty fees.¹⁸ However, only consumers who have accounts with members of those schemes can make a complaint, and whilst the positions taken by COSL and FCDRS are significant and important, in reality they provide coverage for a relatively small proportion of relevant consumers.

¹⁴ See ASIC Pro Forma 209 Australian Financial Services Provider conditions, clause 39 and section 1017G, *Corporations Act 2001* (Cth).

¹⁵ These include the Banking and Financial Services Ombudsman, Credit Union Dispute Resolution Service, Credit Ombudsman Service Limited, Financial Industry Complaints Service Limited and Financial Co-operatives Dispute Resolution Centre.

¹⁶ See <http://www.bfso.org.au/ABIOWeb/abiowebnsf>.

¹⁷ See http://www.afccra.org/Documents_2007%20conference/COSL%20Presentation.pdf, p 31-2.

¹⁸ See <http://www.fcdrs.org.au/>.

A consumers' other option is to approach a court or tribunal with relevant jurisdiction. In many jurisdictions small claims or consumer tribunals would be the appropriate forum, as these have quicker processes and are considerably less expensive than courts. In Victoria, for example, the relevant tribunal is the Victorian Civil & Administrative Tribunal (**VCAT**). It should be noted that not all jurisdictions give consumers access to such tribunals. In these cases consumers must seek redress in the Local Court or Magistrates' Court – a significantly more costly and time consuming exercise, with the additional risk of liability for the costs of the other party if an action is unsuccessful.

Further, approaching either a court or tribunal carries appeal risk – if the consumer's case succeeds, the financial institution may appeal the decision to a higher court, which is likely to increase the consumer's costs risks significantly.

These risks are a significant disincentive to consumers seeking redress from a court or tribunal about the imposition of a penalty fee. Without substantial support to ameliorate this risk rational consumers will be unwilling to pursue the matter.

7. The UK response

Credit card default fees

In April 2006, the OFT released a statement that it viewed default charges in credit card contracts were set at a significantly higher level than is legally fair.¹⁹ Default charges investigated by the OFT included charges for failing to pay on the due date, exceeding a credit limit and failure to honour a payment made. The statement related to the test of fairness set out in the Unfair Terms in Consumer Contract Regulations 1999 (**UTCCRs**). The OFT stated that the principles have wider implications for analogous standard form default terms in other agreements including those for mortgages, current bank accounts and storecards.

Similar to Part 2B of the FTA, a term is considered unfair under the UTCCRs if:

'...contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer'.

In essence, the OFT stated that default charge provisions are open to challenge on grounds of unfairness if they have the object of raising more revenue than is reasonably expected to be necessary to recover certain limited administrative costs incurred by the credit card issuer. The OFT stated that a default charge should:

- reflect a reasonable pre-estimate of the net²⁰ limited additional administrative costs which occur as a result of specific breaches of contract and which can be identified with reasonable precision;

¹⁹ Office of Fair Trading (UK), *Calculating fair default charges in credit card contracts*, April 2006.

²⁰ This denotes that a default charge should take into account a credit card issuer's expected ability to mitigate the loss it suffers as a result of default.

- reflect a fair attribution of those costs between defaulting customers;
- be based on a genuine estimate of the total numbers of expected instances of default in the relevant period; and
- treat costs other than those net limited additional administrative costs as a general overhead of the credit card business and disregard them for the purpose of calculating the default fee.

The OFT did state that it did not insist credit card issuers have default charges that discriminate between different types of default under consideration, and that it would accept a reasonable degree of rounding.

In order to encourage a swift change in market practice, the OFT decided to include in the statement a simple monetary threshold for intervention by OFT on default charges. That threshold was £12.

Following the statement, the OFT requested credit card issuers recalculate their default charges in line with the principles set out in their statement. In response to the OFT's statement, credit card issuers agreed to reduce their default charges – the majority, by half.

Unauthorised overdraft fees – High Court action

Following its success on credit card default charges, the OFT subsequently considered the application of the UTCCRs to the calculation of bank current account charges.²¹ In April 2007 the OFT launched a market study into personal current accounts in the UK.²² The market study proposed consideration of the fairness and impact on consumers generally of the incidence, level and consequences of unauthorised overdraft charges and returned item fees.

The banking industry challenged the view that the OFT's principles outlined in respect to credit card default fees applied to bank current account charges, such as unauthorised overdraft fees. Following this failure to comply, the OFT commenced proceedings in the UK High Court for a declaration on the law in respect of unauthorised overdraft charges.²³ Other parties to the test case constitute approximately 90 per cent of personal current account providers in the UK.

The test case will seek to address two things. First, whether the bank charges are subject to the test of unfairness under the UTCCRs. Second, whether the amount of the charges is unfair. The first stage of the legal action is also expected to cover some additional points of legal principle, in particular, whether these charges can be a penalty at common law.

The test case is structured so as to ensure the process is orderly and well coordinated via a written agreement between the OFT and seven banks, one building society as well as the

²¹ Office of Fair Trading (UK), Press release – Following success on credit card default charges - OFT turns attention to bank current accounts, 7 September 2006.

²² See further below for a discussion of the OFT's power to conduct market studies.

²³ Office of Fair Trading (UK), OFT launches test case on unauthorised overdraft charges, 26 July 2007.

Financial Services Authority.²⁴ For example, the banks have agreed to co-operate with the OFT and each party will pay its own costs of the court action. The hearing will take place on 14 January 2008 and is expected to last eight days.

Relevance of UK action for Australian law

Since at least the enactment of the *Australia Act 1986* (Cth), UK court decisions are not binding on Australian courts. As such, whichever way the UK High Court rules, the finding would not be binding on Australian banks and financial services providers.

Despite this, UK court decisions are persuasive in Australian courts, especially given that longstanding principles which stem from the UK common law are strongly imbibed in Australian common law. But even within these principles, Australian courts are free to exercise a degree of independence and flexibility.²⁵

8. Current regulatory powers that impact on penalty fees

Australian regulators, unlike the OFT, do not commonly undertake market studies. Market studies were introduced by the OFT in 2004 as a means of identifying and addressing all aspects of market failure, from competition issues to consumer detriment and the effect of government regulations. In its 2001 White Paper on Competition, the UK Government stated its wish for competition authorities to take on a high profile advocacy role, both by advising on the impact of the Government's own laws and regulations on competition, and acting more widely to promote competition in the economy in a variety of ways.²⁶ Market studies are one of those ways. The UK government stated such activities would stimulate competition contributing to productivity, innovation and economic growth – hence to long-run economic benefits as well as to more immediate and direct consumer benefits.

The OFT has no specific legislative power to undertake market studies, but does so under section 5 of the *Enterprise Act 2002* (UK) which relates to the OFT and its general functions.²⁷ The OFT has released guidance on how it will approach market studies, which includes information on how it selects markets for review, the types of studies it undertakes, and the outcomes that may result.²⁸

²⁴ See http://www.offt.gov.uk/shared_offt/press_release_attachments/bankagreement.pdf.

²⁵ See, eg, *Fluor Australia Pty Ltd v ASC Engineering Pty Ltd* [2007] VSC 262 (17 July 2007)

²⁶ UK Department of Trade and Industry, *Productivity and Enterprise: a world class competition regime*, July 2001.

²⁷ *Enterprise Act 2002* (UK), section 5: Acquisition of information etc.

(1) The OFT has the function of obtaining, compiling and keeping under review information about matters relating to the carrying out of its functions.

(2) That function is to be carried out with a view to (among other things) ensuring that the OFT has sufficient information to take informed decisions and to carry out its other functions effectively.

(3) In carrying out that function the OFT may carry out, commission or support (financially or otherwise) research.

²⁸ Office of Fair Trading (UK), *Market studies – Guidance on the OFT approach*, November 2004.

The Australian Securities and Investment Commission (**ASIC**) is the Australian regulator with responsibility for financial services, including consumer protection. Section 12A of the *Australian Securities and Investment Commission Act 2001* (Cth) (the **ASIC Act**) provides:

... (2) ASIC has the function of monitoring and promoting market integrity and consumer protection in relation to the Australian financial system.

(3) ASIC has the function of monitoring and promoting market integrity and consumer protection in relation to the payments system by:

- (a) promoting the adoption of approved industry standards and codes of practice; and
- (b) promoting the protection of consumer interests; and
- (c) promoting community awareness of payments system issues; and
- (d) promoting sound customer banker relationships, including through:
 - (i) monitoring the operation of industry standards and codes of practice;
and
 - (ii) monitoring compliance with such standards and codes.

These functions could (and arguably should) support investigations by ASIC into particular market failures, such as the imposition of penalty fees by financial services providers. Like the OFT, other Australian regulators have used broad functions and powers to monitor and promote competitive markets and consumer protection to undertake market investigations.²⁹

In addition to being able to undertake such studies on its own volition, section 12 of the ASIC Act provides that the Minister may give ASIC a written direction about policies it should pursue, or priorities it should follow, in performing or exercising any of its functions or powers. As such, it is possible for the relevant Minister to direct ASIC to undertake a review of penalty fees charged by financial services providers.

One point of difference between OFT's and ASIC's power to investigate and regulate penalty fees is the OFT's specific remit over unfair contract term laws (the UCCTRs). ASIC does not have any function in relation to unfair contract term laws. However, it is clearly arguable that bank account or credit card terms and conditions that allow for the imposition of penalty fees are misleading and deceptive in breach of section 12DA of the ASIC Act. This is because such terms and conditions imply that the imposition of a penalty fee is legal, when it may in fact be imposition of a penalty at law and thus unenforceable. As such ASIC could undertake the relevant investigation to determine a financial services provider's compliance with section 12DA.

The Australian Competition and Consumer Commission (**ACCC**) could also undertake market investigations similar to the OFT, although it is not accustomed to doing so. Section 28 of the *Trade Practices Act 1974* (Cth) provides:

- (1) In addition to any other functions conferred on the Commission, the Commission has the following functions:

²⁹ See Victorian Essential Services Commission, *Early Termination Fees Compliance Review Issues Paper*, July 2005, p 6.

...(c) to conduct research in relation to matters affecting the interests of consumers, being matters with respect to which the Parliament has power to make laws.

It is of course noted that financial services is excluded from the ACCC's powers relating to consumer protection.³⁰ However, this only means that the ACCC cannot take enforcement action in relation to financial services consumer protections, and it retains competition powers relating to the industry. However, it seems unlikely that the ACCC would undertake research relating to penalty fees charged by financial services providers on its own volition.

As with ASIC, however, the Minister may give the Commission directions relating to the performance of its functions or the exercise of its powers.³¹ Using this power, the Minister could direct the ACCC to undertake a market inquiry about penalty fees. Additionally, the TPA empowers either House of Parliament, or a Committee of either House, to provide information or report on particular issues.³² If the Minister failed to act, the Senate, or even the Senate Economics Committee, could request the ACCC to provide information about penalty fees charged by financial institutions.³³

Despite the existence of powers that could be used to undertake market investigations, and despite the significant consumer detriment, neither ASIC nor the ACCC is accustomed to undertaking market studies of this kind and may be unlikely to do so without direction from Government.

9. Options for Regulatory Reform

The trends outlined above suggest that in general, banks are charging higher penalty fees more often and at rates well above the estimated costs. These fees take advantage of, and indeed exacerbate, competitive inefficiencies in our banking and payments system. These fees are a form of market failure and market failure imposes costs on consumers and society that can, and should, be avoided.

We further believe there is a strong case that these fees are unlawful and legally unenforceable, yet relevant regulators have failed to take action on the issue, even though it appears the capacity exists to do so.

Based on the combined market and regulatory failure, CHOICE and Consumer Action support a new regulatory direction to ensure that consumers' interests are adequately protected.

In considering regulatory solutions, we wish to bring to the Committee's attention a series of complementary regulatory tools which may be usefully considered in addition to the *Australian Securities and Investments Commission (Fair Bank and Credit Card Fees) Amendment Bill*

³⁰ Sections 51AAB and 51AF, *Trade Practices Act 1974* (Cth).

³¹ Section 29(1), *Trade Practices Act 1974* (Cth).

³² Section 29(3), *Trade Practices Act 1974* (Cth).

³³ We note that the Senate has previously passed a resolution the ACCC to report on competition issues. See, *Senate Hansard*, 24 September 2001, p 27,647.

2007 (the **ASIC Amendment Bill**) as a suite of reforms to address unfair penalty fees. We consider each in turn.

ASIC Amendment Bill

The ASIC Amendment Bill proposes a regulatory solution to the problem of unfair and potentially illegal penalty fees.

It presents a regulatory solution to 1) disallow deposited cheque dishonour fees, 2) ensure that penalty fees reflect a reasonable estimate of loss, and 3) empower ASIC to enforce the level of penalty fees.

There are significant benefits in pursuing a regulatory reform of this general type. As consumer groups have argued, deposited cheque dishonour fees are uniquely unfair. This fee is charged when a cheque presented for deposit is dishonoured by the bank of the person who wrote the cheque. The customer has no control over the decision by the third party bank to dishonour the cheque, yet is penalised for the action. When CHOICE examined this fee in August 2005, we found the fee could be as high as \$20. Although the 'big four' banks ceased charging this fee some years ago, and Citibank and St George have recently abolished the fee, we are aware that other banks and credit unions continue to levy the fee.

The deposited cheque dishonour fee is one example of a fee that is unfair regardless of amount. In our submission overlimit credit card fees are in the same category (at least where the institution does not give the consumer the option of choosing a 'hard' limit). Multiple fees charged on successive days for the same breach, multiple dishonour fees charged on the same day and fees charged because another bank charge has pushed the consumer's balance over or under the relevant limit are also in this category. Accordingly it is appropriate that some fees are ruled out completely. This could be done in legislation or, more flexible, the power to do so could be given to ASIC.

We believe that there is also merit in solidifying common law principles about illegal penalties in statute. Clarity of the legality of penalty fees will create an environment more conducive to compliance and, where necessary, enforcement action.

Lastly, we believe it is appropriate that ASIC be the authorised regulator to enforce financial institutions' compliance with the law. To date, regulators have avoided taking responsibility for the level of penalty fees. We also believe that, given its implications for consumers across all jurisdictions, this issue requires action at the national level. We therefore support the clarification of regulatory responsibility and enforcement powers established in the bill. The ASIC Amendment Bill would remove the persistent uncertainty in the market to the mutual benefit of both consumers and businesses.

Market Inquiry

As outlined above, a market inquiry by a relevant regulator could investigate the level of fees charged by Australian financial institutions, and make findings and/or recommendations about lawfulness. Such findings could then be used to negotiate with financial institutions so that only fair levels of fees are charged, or as the basis for enforcement action. This model has been used with success in the UK, where credit card issuers responded to the OFT's finding that default fees were excessive.

Either ASIC or the ACCC could undertake market inquiries with their current powers, however neither has seen fit to do so. A minister of government could, however, direct them to undertake a market inquiry. A market inquiry would encourage the regulator to identify market failure, and to seek compliance or take enforcement action. In the absence of such inquiry we do not know what proportion of penalty fee income is cost recovery and what is profit. Further, there is little incentive for the regulator to take compliance or enforcement action.

We note that the ACCC and RBA have previously undertaken a joint market investigation into credit card interchange fees.³⁴ That study found that these fees are higher than can be justified by costs, which led to further regulatory action by the RBA. A similar inquiry into penalty fees may make similar findings, which could result in regulatory action.

Improved data collection and reporting

As noted above, there is little publicly available data regarding the volume of penalty fees charged or the underlying costs of the breaches they are intended to address. The data on penalty fee income is inadequate and consumers would benefit from the more detailed collection of data on penalty fees charged by financial institutions. This could logically be done either by the RBA or by ASIC in conjunction with the market investigations framework mentioned above.

Unfair Contracts Legislation

As described above, the Victorian FTA includes laws which prohibit unfair contract terms in consumer contracts. In the UK, similar laws have been used by the OFT as the basis for its market investigation inquiries. It is our view that such laws should be replicated in both the TPA and the ASIC Act.

Such laws respond to the concern that many standard form contracts, including those relating to deposit accounts and credit cards, contain clauses which are unfair or unnecessarily one-sided to the detriment of consumers. Lack of consumer bargaining power in negotiating standard form contracts, an absence of competition around non-core terms and conditions and significant imbalances of information between businesses and consumers about the nature and effect of

³⁴ Australian Competition and Consumer Commission and Reserve Bank of Australia, *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access*, October 2000.

terms and conditions can result in highly one-sided, “take it or leave it” contracts that can, and regularly do, lead to enormous consumer detriment.

If the ACCC or ASIC had powers to seek compliance and enforce unfair contract terms, it could not only use them to target penalty fees charged by financial institutions, it could inform the terms of a market inquiry. As has been done by the OFT in the UK, the regulator could use the test of fairness in such laws to identify a fair level for penalty fees.

Variation of contract terms on the grounds of hardship

Part of the market failure in the application of penalty fees is the bargaining power of the consumer relative to the financial institution at the time of accepting the terms and conditions. Small business and household consumers have little or no capacity to seek changes to contract conditions.

Division 3 of the Uniform Consumer Credit Code (the **Code**) establishes a model to adjust contract fees and charges on the grounds of hardship. Under the Code, where a debtor is unable reasonably because of illness, unemployment or ill health to meet their obligations, they may apply to the provider to vary the contract.³⁵

A similar model could be adopted in the instance of deposit and credit card accounts. It could allow consumers experiencing serious hardship a remedy to remove specific fees that, in their absence, would enable the consumer to meet their obligations. We note, however, that such a model would require individual consumers to pursue action, and there may be limited scope for a regulator to respond to a systemic problem. This is our experience with the hardship provisions of the UCCC, which have not created an environment of compliance, as institutions are aware that consumers must assert their rights in each specific case. Further such a system if it were utilised extensively would be administratively complex and costly.

Super Complaint Model

The UK's *Enterprise Act 2002* introduces a specific mechanism called the 'super-complaint' which allows designated consumer bodies to complain to the OFT and specific sectoral regulators about market features that may be significantly harming consumers' interests.³⁶ The regulator is statutorily obliged to respond to such a complaint with a certain time frame, announcing what action it will take to deal with the problem. If the regulator does not intend to carry an investigation forward, it must explain the reasons for its decision. Evidence that might be provided in support of a super-complaint includes information on the structure of the market, the way competition works, and how consumers' interests are harmed.

The UK framework recognises that anti-competitive behaviour in consumer markets may be particularly difficult to detect. Where there are a large number of consumers, and most firms

³⁵ Uniform Consumer Credit Code, section (66)(1).

³⁶ *Enterprise Act 2002* (UK), ss 11 and 205.

operate in a similar way, consumers will often not know whether they are getting a raw deal. Further, individual consumers rarely have access to the information necessary to put together a cogent complaint. Without such complaints, the regulators may be unwilling to act. In this situation, the super-complaints mechanism allows consumer groups to articulate and advocate for a large number of consumers.

Super-complaints lodged by consumer bodies in the UK regularly result in regulators undertaking further market investigations, identifying consumer detriment and possible regulatory action or enforcement. A similar model could be adopted under the ASIC Amendment Bill to enable consumer groups to identify penalty fees that are causing harm to consumers. This would require ASIC to respond to a complaint about penalty fees brought by an authorised consumer body, and explain publicly why or why not penalty fees are fair and lawful.

Test Case

If a regulator was unable to seek compliance with findings about penalty fees, or required clarity about the law as it applied to penalty fees, it could pursue litigation to seek a definitive answer from a court. This has been the action of the OFT in the UK, which is pursuing action in the UK High Court.

Similar action could be taken in Australia, if there was sufficient political will to do so. The practical limitations of taking legal action mean that costs risks and appeal risks will inevitably outweigh the benefit to individuals of recovering unfair penalty fees. Consumers are rationally unwilling to pursue their own test litigation, but action could be undertaken by a regulator or a financial institution (acting with other institutions or alone).

10. Conclusion

Consumer Action and CHOICE see an urgent need for regulatory intervention in the level and application of penalty fees. We believe the current regulatory environment is inadequate in protecting the interests of consumers. We further support ASIC as the appropriate regulator to undertake enforcement action on the issue. We believe that the ASIC Amendment Bill would be most usefully enacted alongside a market inquiry conducted by the ACCC or ASIC, and the introduction of national uniform unfair contracts laws in financial services. Super complaints and better data collection should also be considered. We encourage the Committee to endorse a regulatory strategy to address unfair penalty fees.

Appendix 1

Transaction account and credit card penalties

Bank (in alphabetical order)	Periodic payment dishonour (\$)	Direct debit dishonour (\$)	Overdrawn account (\$)	Cheque dishonour (outward) (\$)	Deposited cheque dishonour (\$)	Stop cheque (\$)*	Credit card late payment (\$)	Credit card over limit (\$)
ANZ	35	35	35	35	0	15	35	35
Commonwealth	35	35	30	35	0	15	25	25
NAB	35	50	30 (A)	50	0	5–8	30	25
St George	45	45	38	45	0	8 / 15 (B)	35	30
Westpac	50	50	40	50	0	12	35	35

Source: Banks' fee schedules and product disclosure statements, May 2007.

* The fee usually depends on circumstances. There's often no fee if the cheque is lost, stolen or unsigned and you provide the cheque number, for example.

(A) Charged per day, not per item.

(B) \$15 for staff-assisted request; \$8 to stop a cheque through phone or internet banking.

Appendix 2

The Following letter can be accessed by members of the public at www.fairfees.com.au. It generates an email to the Treasurer, Parliamentary Secretary to the Treasurer, Shadow Treasurer, Shadow Minister for Consumer Affairs and the Shadow Minister for Banking and Financial Services.

This is an issue that impacts on all Australians. Of the 1150 letters sent to date, 369 are from New South Wales, 270 from Queensland, 259 from Victoria, 129 from Western Australia, 66 from South Australia, 26 from Tasmania, 19 from the Australian Capital Territory and 9 from the Northern Territory.

Dear Member of Parliament

I am writing to urge you to do something about unfair penalty fees charged by banks and other financial institutions.

Some of these fees have gone up by 50% in the last 2 years. They generally range from \$35 to \$50 each and can be charged for very minor mistakes by consumers - for example, being one day late with a payment or having \$1 too little in an account when a payment is due.

Penalty fees are for defaults not services. The law states that when it comes to defaults it's only fair for banks to recover their costs, not punish consumers. And while banks have refused to publish the costs they incur when a consumer defaults, overseas evidence suggests costs are as low as a few dollars. In many cases there is clearly little if any cost incurred at all, for example, where the bank earns additional interest on a credit card debt that is paid late or is over the customer's limit. While penalty fees are probably not legally enforceable, it is up to each consumer to challenge these fees, but it is too expensive for a consumer to take legal action against a bank.

The banks and other financial institutions have failed to fix this problem. They propose to give consumers more information, but this misses the point - the penalty fees are unfair and too high, and better disclosure won't create competition to reduce them because consumers do not expect to pay penalties at the time they open a new account.

CHOICE and the Consumer Action Law Centre recommend that government give the Australian Securities and Investments Commission (ASIC) the power to examine penalty fees to determine if they're fair. An ASIC investigation might declare some fees invalid and set a maximum amount for others. I think this is a good solution because it will protect consumers while allowing flexibility as things change in the future.

It would also mean that the most disadvantaged people in our community stop getting charged these unfair fees. The people who can least afford to pay these high fees are the ones who most commonly pay them.

Name, Postcode, State, and other comments